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SIPDIS

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TAGS: [EFIN](#) [IT](#) [EUN](#)

SUBJECT: ITALY'S EU PRESIDENCY: FRANCE'S CHALLENGE TO THE  
STABILITY AND GROWTH PACT AND ASIAN CURRENCY VALUES TOP  
ECOFIN MEETING

REF: A. A. ROME 4236

[1](#)B. B. ROME 1117

[1](#)1. (SBU) Summary. France's continued flouting of Stability and Growth Pact budgetary guidelines dominated the September 12-13 informal ECOFIN meetings in Stresa, Italy. Although most delegations, with Holland and Austria being the most vocal, called for fines to be imposed on France, the French seem to be positioning themselves to dodge sanctions once again. Italian Finance Minister Tremonti's call to review the euro's exchange rate with Asian currencies caught most delegations by surprise. While Tremonti initially seemed to call for an intervention, he and other Italian finance ministry officials, under scrutiny, backtracked quickly and pushed instead for a "comprehensive review of the situation." The Italians expect this issue will be discussed during this weekend's G7 meeting in Dubai. Regarding the EU Constitutional treaty, Eurogroup Ministers did not call for a re-opening of the chapters. However, they noted that if some of the chapters are re-opened during the IGC, the Eurogroup will put forward some new ideas. End Summary.

French Budget Deficit

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[1](#)2. (SBU) Not unexpectedly, France announced at the ECOFIN that it would not comply with the SGP's deficit ceiling - 3 per cent of gross domestic product - for the third consecutive year in 2004. Despite heated criticism and impassioned pleas by other finance Ministers, especially the Dutch Finance Minister Gerrit Zalm, French Finance Minister Francis Mer stated that it is "unrealistic" to expect French to get its books in order in 2004. Italian Finance Ministry and press sources told econoff that it was clear that France's strategy from the start was not to give an inch, although Mer later made conciliatory overtures, stating that his 2004 budget would pave the way for meeting the deficit targets in 2005.

[1](#)3. (SBU) Also evident, sources stated, was the Eurogroup's deep divide over what should be the next step with France. Smaller countries lined up strongly in favor of imposing sanctions, while larger countries, including Italy, and the Commission itself were more willing to give France more time. Commissioner Solbes, trying to avoid a true confrontation with France, dangled out the possibility that if the October 7 ECOFIN finds that France's 2004 budget includes measures to tackle the deficit, ministers would not need to impose disciplinary measures in the short term. "We can not talk about sanctions until France's budget is known," he stated at Friday's press conference. Solbes also made an oblique reference to a provision of the pact that allows a government to exceed its fiscal threshold under "special circumstances". This provision has been a topic of discussion since the Germans went through the same exercise earlier in the year. The "special circumstances" speculated about at that time were the floods of 2002 and the Iraq war. Neither met the criteria. Solbes remarked that interpretation of this EU protocol should be as restrictive as possible.

[1](#)4. (SBU) Comment: There was much grumbling among the smaller delegations, including the soon to be EU members in their first official EU meeting, in the hallways following Solbes' comments. An official from Hungary's Embassy to Rome commented to econoff that, while not surprising, it is remarkable and embarrassing how France and the other big countries can dictate the rules. Press contacts also told econoff that Dutch Finance Minister Zelm continued to fume during the two-day meeting and underscored with them that the Dutch threat to sue the Commission for failure to enforce its own rules is not an empty one. Although Mer later modified his aggressive stance, France's perceived intransigence made for a tense atmosphere. End Comment.

Asian Currencies

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15. (SBU) Italy's preoccupation with the value of Asian currencies left various ministries' officials shaking their heads in confusion. During the September 12th press conference, Finance Minister Tremonti seemed to call for some action to counteract the Euro's climb against Asian currencies. Tremonti stated that during the day's sessions, Eurogroup ministers had discussed the inequilibrium between Europe and Asian currency values, in the context of a discussion of the world economic situation in prelude to eurozone participation in the G7 meeting in Dubai. Tremonti further commented that an "intervento" - literally translated as intervention - might be required. Tremonti's words spun up many of the delegations, including those from Belgium and Luxembourg, who denied to their national press that the ministers had discussed specific actions to address the issue. Italian Finance Ministry officials later tried to clarify Tremonti's remarks, arguing that what he really meant was the need for an urgent and comprehensive review of the situation. The Finance Ministry's spokesperson told journalists that Italy favors a review of the euro's exchange rate not only with China but also India and Japan.

16. (U) Italy expects to issue a statement on behalf of the ECOFIN regarding the inequilibrium of the exchange rate this week. Italian officials also noted that the IMF's managing director will raise the issue of currency valuations in emerging markets during the Dubai meetings next weekend.

17. (SBU) Tremonti's diplomatic advisor told econoff that it was an unfortunate choice of words given the problem of translating its various meanings. (Note: An "intervento" also can mean a speech or to participate in something. End Note.) The advisor added that Tremonti and other Eurogroup ministers understand that they must tread carefully. But Tremonti and a few others agree that this is an urgent matter that needs to be reviewed. A Reuters correspondent told econoff that the Dutch strongly echoed Italian concerns about weak Asian currencies vis-a-vis the euro. In contrast, a BBC correspondent commented to econoff that although he tried to press Chancellor of the Exchequer Gordon Brown on the issue of exchange rates, Brown readily dismissed the issue. When queried about the exchange rate, European Central Bank Governor Wim Duisenberg told journalists that concern is much wider than just the situation in China and discussed the strong effect on eurozone imports of the appreciating euro worldwide. While the ECB did not take an official position on whether exchange rates are satisfactory, Duisenberg warned that the decision to float an exchange needs to be carefully calibrated since many Asian countries carry a heavy bad-loan burden, have weak financial market development and many struggling, if not failing, state enterprises.

18. (SBU) Comment: Several journalists were overheard to be questioning why Italy raised this issue now. One British journalist asked sardonically of other journalists how much they thought the U.S., given Treasury Secretary Snow's recent visit to China, was behind Italy's push. Few seemed to know in Stresa that China has been a hot-button political issue in Italy for several months. The euro's strength vis-a-vis the Chinese yuan and other Asian currencies are being blamed for job losses in Italian export sectors. (Note: See ref A on Italy's debate on the "threat" from China. End Note) And, as early as March, Tremonti raised his concerns with us about China, telling the Ambassador that China is taking away much of western production and markets. (ref B)

#### Eurozone Growth -----

19. (SBU) Regarding economic growth, Finance Ministers, the ECB President, and Commission officials agreed that economic recovery in Europe will not occur earlier than in mid-2004. While officials are encouraged by the positive news coming from the United States and Japan, they are not certain that a recovery in these regions is fully underway or significant

enough to stimulate growth in Europe. On the constitutional treaty produced by the EU Convention, Tremonti said that the Eurogroup has agreed not to ask for a re-opening of the chapters. That said, should the overall text come up for debate at the Inter-Governmental Conference, the Eurogroup does have some concerns about the budgetary powers given to the European parliament and would seek some changes.

10. (U) This cable was cleared by USEU and AMCONGEN Frankfurt.  
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